COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF DELTA NATURAL GAS COMPANY, INC.	))	CASE NO. 9059

O R D E R

On July 6, 1984, Delta Natural Gas Company, Inc., ("Delta") filed its notice with this Commission requesting authority to adjust its rates for gas service rendered on and after July 26, 1984. The rates proposed by Delta would produce additional annual revenues of approximately $2.5 million, representing an increase of 8.8 percent. As a basis for the requested increase, Delta cited the necessity of an adequate income level to provide sufficiently and properly for all expenses of an efficient operation. In addition, Delta maintained that the additional annual revenues were necessary to earn a return sufficient to market its securities, as well as attract new capital at a reasonable cost.

In order to determine the reasonableness of the requested increase, the Commission, by its Order dated July 24, 1984, suspended the proposed rates and charges until December 26, 1984. On October 29, 1984, Delta filed with the Commission revised exhibits wherein it updated its normalized test-period revenues and pro forma expenses. The total effect of these supplemental adjustments on Delta's adjusted net income, rate base, and capital structure resulted in Delta revising the amount of its requested increase to $2,793,070. However, Delta did not propose revised rates to produce this adjusted level of revenue.

On October 31, 1984, a public hearing was held in this matter at the Commission's offices in Frankfort, Kentucky, for the purpose of the cross-examination of Delta's witnesses. Motions to intervene in this proceeding were filed by the Consumer Protection Division of the Office of the Attorney General ("AG") and by the City of Berea, Kentucky. These motions were granted with no other parties requesting intervention. Briefs were filed on November 21, 1984, and responses have been submitted to all requests for information.

This Order addresses the Commission's findings and determinations with regard to its investigation of Delta's revenue requirements and rate design and establishes rates and charges that will produce additional annual revenues of $1,337,697.

COMMENTARY

Delta operates as a public utility in the distribution of natural gas at the retail level to approximately 28,500 customers in the Kentucky cities and towns of Barbourville, Berea, Burning Springs, Camargo, Clay City, Clearfield, Corbin, Farmers-Midland, Frenchburg, Jeffersonville, Kingston-Terrill, London, Manchester, Middlesboro, Nicholasville, Oneida, Pineville, Salt Lick, Stanton, Williamsburg and Wilmore, as well as the rural areas of the Kentucky counties of Garrard and Leslie. In addition, Delta is the owner of all of the issued and outstanding stock of Laurel

Valley Pipe Line ("Laurel Valley"), a Kentucky corporation which is in the business of the purchase, storage and sale of natural gas to and for Delta.

For analytical purposes in this case, Delta filed, and the Commission allowed, consolidated financial statements reflecting Laurel Valley's operations. This consolidation eliminates all inter-company transactions, provides for Delta to recover Laurel Valley's operating expenses, and permits Delta to earn the allowed return on its investment in Laurel Valley's assets.

PURCHASES OF LOCAL PRODUCTION

The Commission commends Delta for its continuing efforts to purchase local production and strongly encourages Delta to continue its local gas purchasing program. All of Delta's customers benefit from each local purchase contract at least to the extent that the contract reduces Delta's overall cost of gas. Contrary to the opinion expressed by the City of Berea in its brief filed November 26, 1984, the Commission is of the opinion that Delta's rates for all customers are lower than would be the case if Delta made no purchases of local production. This is evidenced at least in part by the fact that the rates for Delta's northern system (served primarily by interstate pipelines) were substantially reduced when the rates for the northern and southern sections were combined.

In light of this benefit to all Delta customers, the Commission also strongly encourages Delta to renegotiate any gas purchase contracts which have established escalator clauses or have established Natural Gas Policy Act pricing. The Commission will continue to review Delta's purchasing practices and gas costs with each periodic purchased gas adjustment filing.

TEST PERIOD

Delta proposed, and the Commission has accepted, the 12-month period ended March 31, 1984, as the test period for the determination of the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment Rate Base

In its application, Delta presented a consolidated rate base of $21,736,566, which it subsequently revised to $21,748,316. The Commission, in its examination and analysis of Delta's proposal, has accepted this revised amount with the following modifications:

Planned Construction Expenditures

Delta reported construction work in progress of $448,476 as a component of its March 31, 1984, balance of consolidated property. In its application, Delta proposed that an additional $1.5 million be included in its test-period rate base to reflect a portion of the capital expenditures that were estimated to be made from April 1, 1984, through December 31, 1984. Delta contended that the balance of construction work in progress at March 31, 1984, was not an accurate representation of Delta's annual construction level, but that the $448,476, when combined with the $1.5 million, resulted in a level of construction expenditures that fairly reflected the amounts that would be expended prior to the rates being approved in this case.[1] To further substantiate the inclusion of the $1.5 million in Delta's test period rate base, Mr. Glenn R. Jennings, Executive Vice President, Treasurer and Chief Operating Officer of Delta, testified at the hearing of October 31, 1984, that, although no revision was being proposed to update the $1.5 million, Delta's actual capital expenditures for the period from April 1, 1984, to September 30, 1984, amounted to $2.043 million.[2]

Delta also indicated that, as a a result of its ongoing replacement and upgrading of the facilities, its line loss had decreased to a level of 4 percent, having previously been in the 5 to 6 percent range; hence, Delta maintained that its customers were realizing significant savings through its current rates.[3] However, Delta offered no quantification of any anticipated reduction in its test period operating expenses attributable to the increased efficiency or reduced gas line loss that would result from the $1.5 million in capital expenditures. Moreover, Delta did not propose any reduction in its operating expenses to reflect any anticipated decrease in repairs and maintenance costs attributable to the replacement or upgrading of its facilities.[4]

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1 Prefiled Testimony of Glenn R. Jennings, p. 15.

2 Transcript of Evidence ("T.E."), October 31, 1984, p. 14.

3 Prefiled Testimony of Glenn R. Jennings, p. 14.

4 Response to Commission's Information Request dated August 17, 1984, Item No. 30.

The Commission, in its consideration of this item as a component of Delta's rate base, has concluded that to allow earnings on such capital construction expenditures without associated adjustments to the operating statement results in a mismatch of revenues and expenses and, therefore, violates the rate-making concept of matching rate base, capital and operating revenues and expenses. Consistent with its rate-making treatment of a similar proposal in Delta's previous rate proceeding, Case No. 8528,[5] the Commission has denied Delta's proposed $1.5 million adjustment to rate base.

Gas Plant Acquisition Adjustment

Delta proposed to include in its rate base the unamortized portion of a gas plant acquisition adjustment originally valued at $411,160, which was recorded on the books of Gas Service Company, Inc., ("Gas Service") prior to Delta's acquisition of Gas Service in October, 1977. Subsequently, on December 31, 1979, Gas Service was merged into Delta, at which time the unamortized balance of Gas Service's acquisition adjustment was recorded on Delta's books of account.[6]

In proposing this item as a component of its test-period rate base, Delta argued that such an amount was properly

5 Notice of Adjustment of Rates of Delta Natural Gas Company, Inc., Order dated December 14, 1982.

6 Response to Commission's Information Request dated June 7, 1984, Item No. 15, p. 3 of 4.

includable due to the fact that the acquisition adjustment was the result of amounts paid in excess of book value by Gas Service in acquisitions prior to its purchase by and merger with Delta, and that Delta had been allowed a return on the net book value of this adjustment in Case No. 7202.[7] In addition, Delta maintained that the disallowance of this adjustment in Case No. 8528 was an impediment to good faith bargaining, as no utility could afford to acquire the assets of a company, wherein any newly created or existing acquisition adjustment initially recognized for rate-making purposes would be disallowed in subsequent rate proceedings.[8]

An inequity to ratepayers may occur if a utility is allowed a return on the appreciated cost of acquisitions above book value, while the return granted on existing properties is based on net original cost. Allowing acquisition adjustments could result in the transference of property in order to increase its value for rate-making purposes. Although, in this instance, the acquisition adjustment was recorded on the books of Gas Service prior to its acquisition by Delta, the Commission is of the opinion that the net original cost principle remains applicable. Therefore, the Commission has reduced Delta's net investment rate base by

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7 Adjustment of Rates of Delta Natural Gas Company, Inc., and its Subsidiaries, Gas Service Company, Inc., Cumberland Valley Pipe Line Company and Laurel Valley Pipe Line Company, Inc., Order dated June 29, 1979.

8 Prefiled Testimony of Glenn R. Jennings, p. 17.

$98,960[9] to reflect the disallowance of the test-year end net book value of Delta's acquisition adjustment as it did in the last case. This adjustment results in an adjusted consolidated property balance of $30,068,194.[10]

Working Capital

Delta proposed to include in its rate base an allowance for cash working capital of $695,160 to reflect one-eighth of its proposed test-period operations and maintenance expense, an amount which it subsequently revised to $706,910. The Commission, in its determination of the allowable amount to be included in Delta's rate base, has utilized Delta's methodology which, when based upon the level of operations and maintenance expense found reasonable herein, results in an allowance for cash working capital of $650,141.

Accumulated Depreciation

In developing its rate base, Delta proposed an adjusted test period depreciation reserve of $10,179,176, based upon its actual test period accumulated depreciation adjusted for its pro forma depreciation expense. The Commission has determined Delta's

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Acquisition Adjustment	$411,160
Less:	
Accumulated Provision for Amortization	312,200
Net Book Value	$ 98,960

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Consolidated Property at 03/31/84	$30,167,154
Less:	
Net Book Value of Utility Plant Acquisition Adjustment	98,960
Adjusted Consolidated Property	$30,068,194

allowable accumulated depreciation to be $9,927,828 based upon Delta's actual depreciation reserve adjusted for the amount of depreciation expense found reasonable herein.

Accumulated Deferred Income Taxes

At the end of the test period Delta reported accumulated deferred income taxes of $1,345,700. The Commission has reduced this amount by $5,910 to reflect the exclusion of the amortized balance of excess deferred income taxes thereby resulting in allowable deferred income taxes of $1,339,780. This adjustment, consistent with the Commission's findings in Case No. 8528, is discussed further in this Order in the section entitled Accellerated Recovery of Excess Tax Deferrals.

All other components of the net original cost rate base have been accepted as proposed by Delta. Therefore, the Commission finds Delta's net investment rate base to be as follows:

Consolidated Property	$30,068,194
Less:	
Reserve for Depreciation	9,927,828
Net Consolidated Property	$20,140,366
Add:	
Working Capital	$ 650,141
Prepayments	6,883
Materials and Supplies	669,245
Gas in Storage	175,663
Acquisition Costs of Peoples Gas	43,718
Unamortized Early Retirement--Propane Plant	3,300
Subtotal	$ 1,548,950
Less:	
Accumulated Provision for Deferred Income Taxes	$ 1,339,790
Accumulated Provision for Investment Tax Credit--Pre-1971	20,350
Net Book Value of Non-Utility Property	3,636
Advances for Construction	138,865
Subtotal	$ 1,502,641
Net Investment Rate Base	$20,186,675

Capitalization

According to Jackson Exhibit 1, Schedule 1, Delta reported a test-year end capitalization of $18,948,840 exclusive of deferred investment tax credits. In its revised exhibits, Delta proposed to increase its common equity by $3,865,000 to reflect the proceeds generated from its issue of common stock in October, 1984. This equity issue received Commission approval by an Order dated September 11, 1984, in Case No. 9114.[11] In addition, Delta

11 The Application of Delta Natural Gas Company, Inc., for an Order authorizing the issuance of up to 500,000 shares of Common Stock.

proposed to increase its test-year end balance of short-term debt of $3,600,000 by $1,500,000 to reflect the anticipated short-term debt that would be needed to finance Delta's planned construction expenditures. Delta also proposed to reduce its short-term debt by $3,865,000 to reflect the utilization of the proceeds of the stock issue to retire the existing level of debt. The net result of these two proposals was an adjusted balance of short-term debt of $1,235,000. Thus, after the inclusion of deferred investment tax credits of $1,050,150, Delta proposed an adjusted total test-period capitalization of $21,498,990.

The Commission, in its consideration of Delta's proposed adjustment to its test-period capitalization, has concluded that to allow Delta's proposed $1,500,000 increase in short-term debt would be inconsistent with the Commission's decision regarding planned construction expenditures in the determination of rate base, as Delta indicated that the $1,500,000 of short-term debt would be utilized for construction purposes.[12] Therefore, the Commission has denied Delta's proposal to increase short-term debt by this amount.

In addition, adhering to its findings in Case No. 8528, the Commission has reduced Delta's total capitalization by $3,636 and by $98,960 to reflect the respective disallowances of capital supporting Delta's non-utility property and utility plant acquisition adjustment. The net effect of the Commission's adjustments to Delta's March 31, 1984, capital structure of

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12 Prefiled Testimony of Glenn R. Jennings, p. 22.

$18,948,840 has been to decrease this amount by $102,596 to reflect an adjusted capitalization of $18,846,244.

The Commission has further increased the $18,846,244 by $1,050,150 to reflect the allowance of Delta's March 31, 1984, balance of Job Development Investment Tax Credits ("JDIC"). The JDIC has been allocated to each component of the capital structure on the basis of the ratio of each component to total capital excluding JDIC. The Commission is of the opinion that this methodology is entirely consistent with the requirement of the Internal Revenue Service that JDIC receive the same overall return allowed on common equity, debt and preferred stock. Therefore, Delta's total adjusted capitalization as determined herein is $19,896,394.

REVENUES AND EXPENSES

Delta reported a net operating income of $2,035,418 for the test period. To reflect current and anticipated operating conditions, Delta proposed several adjustments to revenues and expenses resulting in an adjusted net operating income of $1,763,632. As a result of Delta's filing of revised exhibits, this adjusted net income was amended to $1,636,522. The Commission is of the opinion that Delta's proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenue Normalization

Delta proposed to increase its test-period operating revenues by $1,855,889 to reflect normalized sales volumes and purchased gas cost escalations approved by the Commission in Case

No. 8528-J, Notice of Purchased Gas Adjustment Filing of Delta Natural Gas Company, Inc. The amount of this increase was subsequently amended to $1,783,506.

Delta determined its proposed normalized revenues on the basis of the adjustment of actual sales volumes to reflect colder than normal weather conditions, the loss of an interruptible customer, and the loss of a gas transportation contract. The Commission generally agrees with Delta's determination of normalized revenues with one exception.

In the calculation of its proposed weather normalization adjustment, Delta determined the amount of its test-period sales volume requiring normalization on the basis of the reduction of actual sales volumes for non-heat sensitive and base load volumes. This computation resulted in an mcf volume of 2,995,778 that required normalization. To this amount Delta applied a percentage of 7.117 to reflect a sales volume of 213,209 mcf that was attributable to colder than normal weather conditions. Delta determined the 7.117 percent on the basis of a comparison of actual test-year degree days to a 30-year average of normal degree days. As a result of its calculations, Delta determined its total normalized test-period sales volume to be 4,845,044 mcf.

The Commission finds that Delta, in determining its weather normalization adjustment, should have divided the 2,995,778 mcf sales volume by 107.117 percent to achieve a normalized sales volume of 2,796,735 mcf, thereby reflecting an mcf volume of 199,043 attributable to colder than normal weather conditions.

Therefore, the Commission, on the basis of these calculations, has determined Delta's normalized sales volume to be 4,859,260 mcf. The Commission has applied to this volume the rates approved in Case No. 8528-J, resulting in normalized test-period revenues from mcf sales of $30,079,926. This amount, combined with Delta's normalized transportation revenues of $256,566, actual miscellaneous revenues of $61,821, and actual gas well revenues of $16,070, results in total normalized test-period revenues of $30,414,383. The Commission has, therefore, increased Delta's actual test-period revenues by $1,869,020 to reflect this normalized amount.

Purchased Gas Costs

Delta proposed an adjusted test-period purchased gas expense of $20,955,300, which was determined on the basis of the application of the gas cost recovery rate of $4.3251 approved in Case No. 8528-J to Delta's proposed normalized sales volume of 4,845,044 mcf. The Commission, utilizing Delta's methodology, has based its calculations upon the level of normalized mcf sales volume found reasonable herein, which results in an adjusted purchased gas expense of $21,016,569.[13] To reflect this allowable amount, the Commission has increased Delta's purchased gas expense by $1,875,652.

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Normalized mcf sales volume	4,859,210
Gas cost recovery rate	4.3251
Adjusted purchased gas expense	$21,016,569

Late Filed Expense Adjustments

On October 29, 1984, 2 days prior to the hearing in this case, Delta filed with the Commission revised exhibits in which it updated its proposed level of test-period pension expense and right-of-way clearing expense. The total effect of these revisions, which were determined on the basis of Delta's fiscal year-end audit at June 30, 1984, was to increase Delta's test-period operating expenses by $79,000.[14]

The Commission is encountering supplemental adjustments in rate proceedings on a more frequent basis. These adjustments generally reflect additions to update various expenses without requests for additional revenues or increased rates to cover such expenses. It is apparent that, in many cases, additional revenues are not requested because such a request would necessitate the filing of new rate schedules, thereby resulting in a new 5-month suspension period being imposed.

In Case No. 8924, The Adjustment of Rates of Louisville Gas and Electric Company, the Commission, having found that untimely filed adjustments hamper both the Commission's and intervenors' investigations of a case, disallowed adjustments that were proposed subsequent to the filing of the original application. In disallowing these items, the Commission also raised questions as to whether intervening parties receive due process in such instances.

[14] Revised Hall Exhibit C-1, p. 2 of 2.

The Commission finds that a similar situation has occurred with Delta in this proceeding. With regard to the revised adjustments for pension expense and right-of-way clearing expense, the Commission, noting that Delta is required to maintain monthly operating reports on file with the Commission, questions the 4-month delay in the filing of these revised expense adjustments, when such information would have been available shortly after the filing of this case. Thus, had the adjustments been filed on a more timely basis, the Commission, as well as the intervenors, would have been afforded an adequate opportunity to consider Delta's proposals.

In proposing these revisions, Delta maintained that the revisions were necessary to reflect known and determinable changes to Delta's level of operations during the time that the proposed rates would be in effect.[15] However, the Commission is of the opinion that adjustments such as these, which reflect changes occurring 3 months subsequent to the test year's end, are not consistent with the concept of a historical test period and the matching of earnings, rate base, and capital. Therefore, the Commission has denied Delta's proposal to update its pension expense and right-of-way clearing expense to June 30, 1984, levels.

Rate Case Expense

In its application Delta proposed an adjustment to increase its test-period operating expenses by $25,000 to reflect its

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15 Revised Exhibits, p. 1.

estimated rate case expense of $50,000 amortized over a period of 2 years. Delta subsequently revised this adjustment to $40,000 as it increased the estimated amount of the total costs associated with this proceeding to $80,000.[16] The total amount of rate case expense was again revised to $65,000; hence, Delta proposed a test-period rate case expense of $32,500.[17] The Commission, upon its consideration of this item, has determined that Delta should be allowed to increase its test-period operating expense by $29,435 to reflect the amortization, over a period of 2 years, of the actual amount of rate case expense of $58,820 incurred by Delta as of November 14, 1984.[18]

Accelerated Recovery of Excess Tax Deferrals

Delta indicated that, as a result of the reduction in the corporate tax rate in 1979 from 48 percent to 46 percent, its excess tax deferrals were computed to be $9,848.[19] In Case No. 8528, the Commission determined that, in order to insure that this surplus amount was credited to the ratepayers who originally paid the taxes at 48 percent, these excess deferred taxes should be amortized over a period of 5 years. Therefore, adhering to its findings in Case No. 8528, the Commission has increased Delta's

16 Revised Hall Exhibit C-1, p. 2 of 2.

17 Response to Information Requested at Hearing of October 31, 1984, Item No. 8.

18 Ibid.

19 Response to Information Request dated June 7, 1984, Item No. 19.

operating income by $1,920 to reflect the amount of amortization applicable to test-period operations. In addition, as previously indicated in this Order, the Commission has made a corollary adjustment to reduce accumulated deferred income taxes by $5,900 to reflect 3 years' amortization of the excess deferred taxes.

Outside Services Employed

During the test period, Delta reported costs from professional and other outside services in the total amount of $343,530 as having been incurred. Included in this amount were expenses totaling $45,583 that were paid to Stone and Webster Management Consultants, Inc., ("Stone and Webster") in association with an organization study, a compensation study, and a risk-management study. Delta stated that, as a result of these studies, its customers had realized benefits in the form of significant cost reductions in the areas of insurance and wages and salaries.[20]

Although these studies provided useful information to Delta and constituted valid expenses of the test period, no evidence was presented in this proceeding to indicate that such costs would be incurred on a recurring basis. Inasmuch as Delta reported the $45,583 as an operating expense of the test period, it is apparent that, for book purposes, Delta chose not to amortize this expense. Therefore, the costs associated with these studies will not impact future periods and should not be reflected in adjusted operating expenses. Thus, for the purpose of determining rates in this

20 Response to AG's Information Request dated August 10, 1984, Item No. 17.

case, the Commission has not included the total expense of $45,583 associated with the Stone and Webster studies in Delta's adjusted operating expenses.

Expenses Related to Legislative Session

Delta related that, although it did attend various committee meetings on energy issues during the 1984 Kentucky General Assembly, none of the expenses incurred could be classified as lobbying-related. Delta further indicated that these meetings were also attended by its outside legal counsel, but that the associated fees paid to its counsel were considered to be expenses incurred as part of the routine legal services provided to Delta.[21]

At the hearing of October 31, 1984, it was revealed that two members of Delta's outside legal counsel had registered with the AG as lobbyists on behalf of Delta. However, Delta argued that such activities should be considered legal representation and advice instead of direct lobbying activities.[22]

According to the statement of lobbying expenses which Delta's legal counsel filed with the AG, Delta incurred total legal expenses of $6,653 which were directly related to the legislative session.[23] In addition, Delta also indicated that, of the total amount of legal expenses incurred during the test

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21 Response to Commission's Information Request dated June 7, 1984, Item No. 28.

22 T.E., October 31, 1984, pp. 185-186.

23 Response to Information Requested at Hearing of October 31, 1984, Exhibit B, pp. 1-2.

period, $8,557 represented expenses incurred in association with legal services related to the session.[24] In addressing this area, Mr. Jennings did not state what he considered lobbying to be; but, the attendance of meetings and the presentation of written and oral testimony is the very essence of lobbying activity.

In determining the portion of a utility's operating expenses to be allowed for rate-making purposes, the Commission notes that the Uniform System of Accounts states that "expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation or ordinances..." shall be considered non-operating in nature and thereby classified as miscellaneous deductions to income. The Commission is of the opinion that Delta's legal expenses in this instance fall directly within this classification. Therefore, for the purposes of determining rates in this case, the Commission has excluded $8,557 from Delta's test-period operating expenses.

Wages and Salaries

Delta proposed an adjustment to increase its test-period level of wages and salaries by $301,900. This increase was formulated on the basis of the annualized level of wages and salaries at May 23, 1984, adjusted for a 5 percent wage increase effective July 1, 1984. Delta also indicated that a portion of its proposed increase was based on the salaries of positions which were vacant at the end of the test period but which were filled or

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24 T.E., October 31, 1984, p. 217.

expected to be filled between August and December, 1984. In addition, Delta's proposed adjustment included an increase in employee benefits based upon a percentage of the total increase in wages and salaries.

The amount of compensation provided to Delta's employees, particularly the level of executive compensation, has been a major issue in both of Delta's prior two rate proceedings before this Commission. In each of those cases, Delta was denied its pro forma level of wages and salaries.

Since the Commission's December 14, 1982, decision in Case No. 8528, Delta has reorganized its executive level positions, as well as restructured the salaries associated with these positions. These changes were implemented on the basis of an organizational study conducted by Stone and Webster which resulted in a reduction in the number of Delta's executive officers to six positions, whereas, prior to the reorganization, Delta maintained nine executive officers and three assistant officers.[25] The Commission, noting its finding in Case No. 8528 that the number of persons retaining officer status was excessive, is of the opinion that Delta's reorganization of its executive level positions reflects progress in an area that has been the source of much debate.

Upon the implementation of these organizational changes, Stone and Webster conducted a compensation study in which the pay

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25 Prefiled Testimony of Glenn R. Jennings, p. 31.

structure of Delta's officer and upper management positions was revised. As a result of Stone and Webster's recommendations, Delta implemented a new pay grade system effective July 1, 1983.[26]

Delta related that, due to its restructured compensation program, the total amount of salaries paid to its officers and upper management employees decreased by $53,750, reflecting a reduction of 10.5 percent.[27] However, an examination of the salaries before and after the restructuring revealed that $45,000 of this reduction was the result of the retirement of one employee whose duties and responsibilities were consolidated with those of an existing employee. In a comparison of the salaries of those personnel who remained on Delta's payroll after the restructuring, it was determined that, net of the $45,000 salary of the retired employee, Delta had realized a reduction in its executive level compensation of only 1.87 percent, an amount which Delta confirmed upon cross-examination at the October 31, 1984, hearing.[28]

In determining the allowable amount of wages and salaries to be included in Delta's adjusted test-period operating expenses, the Commission has given due consideration to Delta's actual test-period wages and salaries, as well as its proposed adjustments to the actual amounts. With regard to Delta's proposed adjustments for the vacant positions which were to be filled subsequent to the

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26 Ibid.

27 Ibid., p. 34.

28 T.E., October 31, 1984, p. 67.

end of the test year, the Commission finds such adjustments to represent speculative conditions which, due to the post-test period nature of the vacancies, violate the concepts of the historic test period and the matching of revenues and expenses. Therefore, for the purposes of determining rates in this proceeding, the Commission has restricted Delta's allowable wages and salaries to the actual test year amount. In addition, the Commission will continue to examine in future rate proceedings the amount of compensation provided to Delta's executive-level employees and it hereby notifies Delta that in such instances the burden of proof regarding the reasonableness of executive compensation will rest solely with Delta.

Personal Expenses

During the test period, Delta reported total expenses of $41,199 which were indicated to have been costs incurred by Delta's employees while on company business. Although classified as personal expenses, Delta indicated that these costs represented business-related travel, meals, and lodging.[29]

Delta was asked to present an analysis of these costs whereby expenses of more than $100 in value were to be categorized according to the business nature of the individual item. This analysis, as originally submitted by Delta, did not reflect the information in the form requested by the Commission. Therefore, Delta was requested at the hearing of October 31, 1984, to

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29 Response to Commission's Information Request dated September 24, 1984, Item No. 14.

resubmit this information in the format originally requested. An examination of the resubmitted information revealed that, of the $41,199 of total expense, an amount of $8,545 lacked any explanation regarding the business nature of the associated expense. As the Commission is of the opinion that Delta was afforded adequate opportunity to present this information, it has disallowed the $8,545 of expenses for which no explanation was given.

Depreciation Expense

Delta proposed an adjustment to increase its test-period depreciation expense by $112,400 to reflect the amount of depreciation on the balance of utility plant in service at March 31, 1984, increased for the amortization of its acquisition adjustment, for the amortization of the early retirement of propane plant, and for the depreciation on construction work in progress. In addition, $60,000 of Delta's proposed adjustment reflected the amount of estimated depreciation associated with Delta's planned construction expenditures of $1,500,000.

In its determination of the amount of depreciation expense to be allowed for rate-making purposes, the Commission has reduced Delta's test-period depreciation by $16,800 to reflect the disallowance of the amount of amortization of Delta's acquisition adjustment. In addition, the Commission has made a reduction of $1,552 to reflect the disallowance of depreciation associated with Delta's non-utility property.

With regard to Delta's proposed increase of $60,000 to reflect depreciation on its planned construction expenditures, the

Commission has denied this adjustment on the basis of its disallowance of these planned expenditures in the determination of Delta's net investment rate base. Therefore, the Commission has determined the alowable amount of depreciation expense in this case to be $1,022,039, and has increased Delta's test-period depreciation expense by $22,252 to reflect this amount.

Property Taxes

Delta proposed an adjustment to increase its test-period property taxes by $23,800 to reflect the estimated amount of taxes associated with its balance of property at March 31, 1984, as well as the amount of taxes associated with the $1.5 million of planned construction expenditures. In determining this adjustment, Delta based its calculation on the amount of property taxes paid during 1983 expressed as a percentage of Delta's property valuation at December 31, 1982. This percentage was subsequently applied to Delta's balance of property at March 31, 1984, as well as the amount of planned construction expenditures, to determine the level of adjusted test-period property tax expense.

The Commission, in its determination of Delta's adjusted property tax expense, has utilized Delta's methodology based upon the balance of property at March 31, 1984, thereby resulting in an increase of $14,781 in Delta's tax expense. With regard to Delta's proposed inclusion of property taxes on the $1.5 million in planned construction expenditures, consistent with its disallowance of these expenditures and associated adjustments in prior sections of this Order, the Commission has denied this adjustment accordingly.

Income Taxes

Delta proposed to decrease its test-period income taxes by $210,940 to reflect the pro forma amount of taxes based upon Delta's adjusted net income. The Commission, in its determination of the allowable amount of Delta's test-period income taxes, has based its calculations upon Delta's adjusted net income as determined herein, thereby resulting in an adjustment to increase Delta's test-period income taxes by $105,577.

Interest Synchronization

In its application Delta proposed an adjustment to decrease its test-period interest expense by $10,877 to reflect anticipated interest levels. This amount was computed on the basis of the test-year end balance of debt adjusted for the additional short-term debt of $1.5 million associated with Delta's planned construction expenditures. This adjustment was subsequently amended in Delta's revised exhibits to reflect an interest expense reduction of $97,502.

Historically, for rate-making purposes, the Commission has imputed interest expense on the portion of JDIC assigned to the debt components of the capital structure and has treated the interest as a deduction in computing the amount of federal income tax expense allowed in the cost of service. The Commission has encountered opposition from several utilities concerning this treatment of JDIC. For instance, Continental Telephone Company ("Continental") has had two cases on appeal in the Kentucky Court of Appeals under Docket Nos. 82-CA-2657-MR and 83-CA-431-MR in which one of the issues was the Commission's treatment of JDIC.

On April 13, 1984, the Court of Appeals issued contradictory opinions in the two cases and directed that the matter be pursued in the Kentucky Supreme Court. Those cases are now before the Supreme Court and a final decision is expected some time next year. Having received contradictory opinions from the Court of Appeals, the Commission has reserved this matter in other cases pending a final judicial decision on this matter. The initial case in which such action was taken was Case No. 8734, General Adjustment in Electric Rates of Kentucky Power Company. In that proceeding, at the request of Kentucky Power to avoid any additional judicial review on this issue, the Commission stated that, should the final judicial opinion in the Continental cases be adverse to the Commission's position, it would then consider a rate adjustment to generate the revenues associated with the debt component of JDIC.

The Commission continues to be of the opinion that its past treatment of JDIC is proper and consistent with Internal Revenue Service regulations and such treatment will be continued in this proceeding. However, as in Case No. 8734, the provisions of this Order should eliminate the need for appeal of this matter at the judicial level. Therefore, Delta is hereby apprised that, should the final judicial opinion in the case(s) of Continental be adverse to the Commission's position on interest associated with JDIC, the Commission, upon its receipt of an appropriate application by Delta, will order a rate adjustment to generate the associated revenues which have been denied herein.

Therefore, in accordance with its past practice, the Commission has applied the appropriate cost rates to the JDIC allocated to the debt components of Delta's capital structure. On the basis of the adjusted capital structure allowed herein, the Commission has determined that Delta's test period interest expense should be reduced by $162,743 to reflect an allowable interest expense of $1,021,761.

Therefore, the Commission finds Delta's adjusted test-period operations to be as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$28,545,363	$1,869,020	$30,414,383
Operating Expenses	26,509,945	2,006,870	28,516,815
Net Operating Income	$ 2,035,418	$ <137,850>	$ 1,897,568

CAPITAL STRUCTURE

Mr. Robert S. Jackson, Senior Vice President of Stone and Webster, and witness for Delta, proposed an adjusted end-of-test-year capital structure containing 38.11 percent long-term debt, 5.74 percent short-term debt, 5.19 percent preferred stock, 46.08 percent common equity and 4.88 percent deferred investment tax credits.[30] The end-of-test-year capital ratios were adjusted to reflect the sale of $3,865,000 of new common equity beyond the test year. The capital ratios were also adjusted to reflect the retirement of short-term debt and the

30 Jackson schedule 4, revised.

issuance of new short-term debt beyond the test year. The proceeds from the sale of common equity were used to retire short-term debt while the proceeds from the sale of new short-term debt will be used to finance planned construction.[31] The adjustments to Delta's end-of-test-year capital structure are reasonable and reflect actual changes that have occurred beyond the test year. Therefore, the Commission is of the opinion that a capital structure containing 40.06 percent long-term debt, 6.04 percent short-term debt, 5.46 percent preferred stock and 48.44 percent common equity is reasonable and will be used to determine the appropriate weighted cost of capital to Delta. The Commission will continue its policy of excluding investment tax credits from the capital ratios.

RATE OF RETURN

Mr. Jackson proposed a 9.7 percent embedded cost for Delta's fixed rate long-term debt and a 12.88 percent cost for its variable rate long-term debt.[32] He also proposed a 12.5 percent cost for Delta's short-term debt and a 10 percent embedded cost for its preferred stock.[33] The cost of Delta's variable rate long-term debt is based on the current prime rate plus 25 basis points. The cost of Delta's short-term debt is equal to the

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31 Revised Exhibits to the Direct Testimony of John Hall and Robert Jackson, filed October 29, 1984.

32 Jackson schedule 4, revised.

33 Ibid.

current prime rate. The average prime rate for the 12 months ended in October, 1984, was approximately 12 percent.[34] The Commission is of the opinion that an 11.01 percent overall cost of long-term debt is reasonable.[35] The Commission is also of the opinion that a 12 percent cost for short-term debt and a 10 percent cost for preferred stock are also reasonable.

Mr. Jackson proposed a 17 percent return on equity for Delta, based on a discounted cash flow ("DCF") analysis.[36] He selected a group of gas distribution utilities, with operating revenues under $100 million, and performed a DCF analysis on the group to determine the cost of equity to Delta.[37] Using a weighted average of the growth rates in earings per share, dividends per share and book value per share, Mr. Jackson concluded that a 7.3 percent growth rate was reasonable for use in his DCF calculation.[38] Adding the 7.3 percent growth rate to the group's average 1983 dividend yield produced a 16.85 percent required return on equity. Mr. Jackson adjusted that figure upward to 17 percent (to compensate for selling expenses and market pressure) so that the indicated return on equity would be

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34 Federal Reserve Statistical Release.

35 Based on a 9.7 percent cost for Delta's fixed rate long-term debt and a 12.38 percent cost for its variable rate long-term debt (a 12.25 percent cost adjusted for issuance expenses).

36 Prefiled Testimony of Robert S. Jackson, page 3.

37 Ibid., p. 6.

38 Ibid., p. 10.

sufficient to produce a market to book ratio between 1 and 1.05.[39] Mr. Jackson was of the opinion that a 17 percent return on equity for Delta was "barebones."

The Commission is of the opinion that Mr. Jackson's recommended rate of return overstates the investor required return for Delta. Mr. Jackson used a 9.55 percent dividend yield in his DCF calculation. However, using more current stock prices, the dividend yield falls to 8.07 percent.[40] The growth rate component used in the DCF calculation was derived using a least squares methodology. A trend line is fitted to the data and the slope of the line provides the growth rate. The growth rates Mr. Jackson derived for his comparison group, using that methodology, tended to be volatile. For instance, the 5-year earnings per share growth rate varied from negative 4.43 percent for Southeastern Michigan Gas Enterprises to 40.48 percent for Wisconsin Southern Gas Co.[41] Mr. Jackson also calculated a 4.42 percent average dividend growth rate for his comparison companies using the retention rate times the return on equity ("b x r") method.[42] Delta's indicated dividend rate has increased from $1 per share to $1.04 per share (or a 4 percent growth in dividends per share) since the end of the test year.[43]

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39 Prefiled Testimony of Robert S. Jackson, page 13.

40 T.E., October 31, 1984, p. 124.

41 Staff request dated August 17, 1984, Item 1, p. 1.

42 Prefiled Testimony of Robert S. Jackson, p. 10.

43 T.E., October 31, 1984, p. 119.

The ask price for Delta's stock is currently in excess of $10 per share, as quoted in the November 29, 1984, issue of the Wall Street Journal. Despite the recent sale of common stock, Delta's market to book ratio remains in excess of 1.[44] A market to book ratio of 1 or better tends to indicate that investors perceive Delta's return on equity to be adequate. Delta also has a very conservative capital structure which tends to reduce its risk.

In its brief, the AG recommended a rate of return on equity in the range of 14.5 to 15 percent.[45] The City of Berea was of the opinion that Delta's requested return was unreasonable.[46]

After considering all of the evidence, including current economic conditions, the Commission is of the opinion that a rate of return on common equity in the range of 14.5 to 15.5 percent is fair, just and reasonable. A return on equity in this range will not only allow Delta to attract capital at reasonable costs to insure continued service and provide for necessary expansion to meet future requirements, but also will result in the lowest possible cost to the ratepayer. A return on equity of 15 percent will best meet the above objectives.

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44 Staff request dated June 7, 1984, Item 4, p. 3.

45 AG's Brief, p. 3.

46 City of Berea's Brief, p. 3.

Rate of Return Summary

Applying rates of 11.01 percent for long-term debt, 12 percent for short-term debt, 10 percent for preferred stock and 15 percent for common equity to the capital structure approved herein produces an overall cost of capital of 12.95 percent. The additional revenue granted herein will provide a rate of return on net investment of 12.76 percent. The Commission finds this overall cost of capital to be fair, just and reasonable.

REVENUE REQUIREMENTS

The Commission has determined that Delta needs additional annual operating income of $679,015 to produce an overall rate of return of 12.95 percent based on the adjusted historical test year. After the provision for taxes, there is an overall revenue deficiency of $1,337,697 which is the amount of additional revenue granted herein. The net operating income required to allow Delta the opportunity to pay its operating expenses and fixed costs and have a reasonable amount for equity growth is $2,576,583. To achieve this level of operating income, Delta is entitled to increase its annual revenues as follows:

Reasonable Net Operating Income	$2,576,583
Adjusted Net Operating Income	$1,897,568
Net Operating Income Deficiency	$ 679,015
Additional Revenues Required	$1,337,697

The additional revenue granted herein will provide a rate of return on the net original cost rate base of 12.76 percent and an overall return on total capitalzation of 12.95 percent.

Based on the adjusted test year, the rates and charges in Appendix A are designed to produce gross operating revenues of $31,674,189 which reflects the roll-in of all gas cost adjustments approved through October 12, 1984, in Case No. 8528-L, Purchased Gas Adjustment Filing of Delta Natural Gas Company, Inc.

RATE DESIGN AND REVENUE ALLOCATION

Delta proposed to increase its customer charge, add a fourth step to its declining block rate design, and add rates for standby service and on-system transportation service. Ms. Carol A. Kinzler, Senior Consultant of Stone and Webster, stated at the hearing that the objectives considered when designing these new rates were to design flexible and competitive rates, retain industrial load and improve fixed cost recovery through increased minimum charges, all without placing any undue hardship or burden on any single class of customers.[47]

The AG stated in its brief filed November 21, 1984, that Delta's rate design proposal is arbitrary and should be rejected. Regarding Delta's objective of retaining industrial load the AG notes that Delta has not lost any industrial customers since this case was filed. The AG also stated that the increase in the customer charge sought by Delta was unnecessary and buttressed only by unsubstantiated subjective analysis.[48] However, the AG

47 T.E., October 31, 1984, pp. 141-144.

48 AG's Brief, pp. 4-5.

failed to provide the Commission with an alternative proposal for the allocation of any revenue increase to Delta's existing rate design.

Delta supported its proposed increase in the customer charge for the GS rate from $2.90 to $5.00 with a calculation of costs allocable on a customer basis.[49] However, Delta's witness Ms. Kinzler, did not do a detailed cost-of-service analysis. The Commission is not convinced that Ms. Kinzler's calculation was appropriate in this case. Therefore, the Commission has decreased the proposed customer charge by the amount of decrease in Delta's proposed revenue increase resulting in a customer charge of $3.90.

Delta proposed the addition of a fourth declining block at 1000 mcf. Currently, Delta's rate schedule includes a first block ranging from 1 to 5000 mcf. Ms. Kinzler stated that most utilities opt for smaller block increments for both cost of service reasons and to allow some pricing flexibility. To allow for more competitively priced tail block rates, Delta proposed steeper interblock discounts.[50] In Delta's existing rates the discount between the first and last block is $.50. Delta is proposing to increase this discount to $1.25, thereby decreasing the rates charged to customers purchasing over 5000 mcf. Delta argued that the cost of gas should be kept at a competitive level

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49 Prefiled Testimony of Carol A. Kinzler, Kinzler Exhibit 1.

50 T.E., October 31, 1984, p. 142.

with alternate fuels thereby retaining the sales load of the industrial class capable of switching to another fuel source.[51]

The Commission feels that Delta may have ignored the principle of gradualism in its approach, thereby failing to meet its own fourth objective. Therefore, the Commission approves Delta's request for the addition of a fourth block but denies the proposed amount of the interblock discount. The Commission finds it unjust and unfair to decrease the rates charged to large volume users, yet increase those charged to users of 5000 mcf or less, without compelling cost of service support. The Commission will allow the existing rate for gas purchases over 10,000 mcf to remain the same, therefore enforcing no increase on this block of customers. The discount between each of the last three blocks shall be $.30, with the discount between the first and second block being the amount necessary to produce the remaining amount of revenue needed to meet Delta's revenue requirement. The approved Interruptible Rates Schedule consists of like declining blocks with unit commodity charges priced at $.25 below the GS rates as proposed.

Delta proposed a new rate for standby service. This service will be provided on a negotiated basis to commercial and industrial customers who purchase all or part of their natural gas requirements from sources other than Delta and who request Delta to be available to supply natural gas at their place of utilization; or, request Delta to provide a standby energy source

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51 Prefiled Testimony of Robert Hazelrigg, pp. 4-6.

at their place of utilization.[52] Based on an evaluation of various factors on a case by case basis, the customer will pay Delta a contracted standby charge in addition to the normal GS or interruptible rates.[53] The Commission is of the opinion that the creation of this new rate will be of benefit to both Delta and its customers and should be approved. Of course, any contract between Delta and a customer for standby service must be submitted to the Commission for its approval prior to being effective.

Delta has proposed a new transportation tariff for on-system customers. The tariff is designed to recover the same margin (revenue minus cost of gas) from a self-help customer as would be recouped if the customer were buying gas from Delta. In designing this rate Ms. Kinzler stated that a tail block margin of between $.50 and $1.00 represents a reasonably competitive range.[54] The approved rates provide a margin above the cost of gas in the tail block of the firm and interruptible rates of $1.23 and $.98, respectively. Considering that Delta's tail block for both firm and interruptible rate schedules has not increased and is well within the 15 percent premium range that natural gas can command over #6 fuel oil,[55] the Commission is of the opinion that these rates are reasonable and should be approved. In order to allow for the flexibility to meet the competitive fuel market, the

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52 Prefiled Testimony of Carol A. Kinzler, p. 12.

53 Ibid.

54 Ibid., p. 8.

55 T.E., October 31, 1984, p. 172.

Commission may allow a reduced transportation rate for present or future customers of transportation service upon approval of a contract filed with the Commission which outlines the requirements for the reduced rates.

FINDINGS AND ORDERS

The Commission, after examining the evidence of record and being advised, is of the opinion and finds that:

1. The rates and charges proposed by Delta would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates and charges in Appendix A are the fair, just and reasonable rates to be charged by Delta.

3. The rates of return granted herein are fair, just and reasonable and will provide for the financial obligations of Delta with a reasonable amount remaining for equity growth.

IT IS THEREFORE ORDERED that the rates and charges proposed by Delta be and they hereby are denied.

IT IS FURTHER ORDERED that the rates and charges in Appendix A be and they hereby are fair, just and reasonable rates to be charged by Delta for service rendered on and after December 26, 1984.

IT IS FURTHER ORDERED that Delta shall file with the Commission within 30 days from the date of this Order its revised tariff sheets setting out the rates and charges approved herein.

Done at Frankfort, Kentucky, this 21st day of December, 1984.

PUBLIC SERVICE COMMISSION

Dissented

~~Chairman~~

Vice Chairman

Commissioner

ATTEST:

Secretary

DISSENTING OPINION OF CHAIRMAN RICHARD D. HEMAN, JR.

I dissent only from that part of the Opinion and Order which disallows the inclusion in Delta's rate case of the unamortized portion of the acquisition adjustment relative to Gas Service. This adjustment was recorded on the books of Gas Service prior to its acquisition by Delta. This Order reduces Delta's net investment rate base by $98,960 to reflect the disallowance.

In Case No. 6879 - In the Matter of the Application of Delta Natural Gas Company, Inc., for an Order Authorizing the Issuance and Sale of its First Mortgage Bonds, 9-3/8%, Due 1992, in the Amount of $4,430,000; 60,000 Shares of 10% Preferred Stock; and 20,000 Shares of Common Stock - (Order entered September 8, 1977) - Delta was authorized, among other things, to issue and sell First Mortgage Bonds in the amount of $4,430,000 at an annual interest rate of 9-3/8 percent. The proceeds of the sale were to be used for the acquisition of all of the capital stock in Gas Service, Laurel Valley Pipe Line Company and Cumberland Valley Pipe Line Company, to acquire oil and gas leases covering gas storage facilities located near Pineville, Kentucky, and to retire certain indebtedness of Cumberland Valley Pipe Line Company after acquisition. A hearing was not held. Subsequently, Delta paid net book value for the assets of Gas Service. As stated, the adjustment in question was recorded on the books of Gas Service at the time of acquisition. In 1979 Gas Service was merged into Delta.

In Case No. 7202 - In the Matter of Adjustment of Rates of Delta Naural Gas Company, Inc. and its Subsidiaries, Gas Service Company Inc., Cumberland Valley Pipe Line Company and Laurel Valley Pipe Line Company, Inc. - (Order entered June 29, 1979) - the Commission authorized a return on the net book value of the acquisition adjustment. The Order (page 2) discusses the three companies acquired by Delta; Gas Service, Cumberland Valley Pipe Line Company, and Laurel Valley Pipe Line Company, all to be organized as Delta's south division. The Order refers to the many reports in the Commission's files concerning the quality of service in the area and states that one reason the Commission was in favor of the acquisition was the strong commitment by Delta's management to upgrade the south division.

In Case No. 8256 - In the Matter of Notice of Adjustment of Rates of Delta Natural Gas Company, Inc. - (Order entered December 1, 1981) - the Commission reduced Delta's proposed rate base by $149,360, the net book value of the acquisition adjustment and stated at page 6 of the Order:

> It is the Commission's opinion that it is unfair to require the ratepayers to provide a higher return on utility plant <u>simply</u> because it has been sold at a cost above book value. The Commission considers that the original cost of plant devoted to public service is the appropriate valuation for a determination of revenue requirements (emphasis supplied).

In Case No. 8528 - In the Matter of Notice of Adjustment of Rates of Delta Natural Gas Company, Inc. - (Order entered December 14, 1982) - the Commission reduced Delta's proposed rate base by $132,560 to reflect the net book value of its acquisition adjustment and stated at page 4 of the Order:

> It is the Commission's opinion that it is unfair to require the ratepayers to provide additional monies on utility plant simply because it has been sold at a cost above book value. The Commission considers the net original cost of plant devoted to public service to be the appropriate valuation for a determination of revenue requirements (emphasis supplied).

I believe the unamortized portion of the acquisition adjustment ($98,960) sought herein should be allowed. I believe the Commission must examine the facts and circumstances concerning a proposed acquisition adjustment. It may disallow the entire amount, or it may determine, based on substantial service improvements, operating efficiencies and the like, that a portion or all of the adjustment should be allowed. The record must demonstrate that the consumers are benefited by the acquisition.

The above statements from the Commission's Orders in Case No. 8256 and Case No. 8528 are, in my opinion, correct. No acquisition adjustment should be recognized simply because a utility plant has been sold at a cost higher than book value. I couldn't agree more. However, this is not the case with respect to Gas Service. Delta was authorized a return on the net book value of the adjustment in Case No. 7202. The Order in that case included a specific reference to Delta's commitment to upgrade facilities and improve the quality of service.

Although the Commission, in Case No. 8256 and Case No. 8528, reversed and disallowed the unamortized portion of the acquisition adjustment, I find no refutation of the earlier determination in Case No. 7202 relative to the committed service improvements and no consideration of the facts and circumstances of the purchase price. It had become a matter of policy. Allowance of the amortization in Case No. 7202 was, in effect, a ratification of the validity of the adjustment.

At page 42 of the transcript of the hearing held October 31, 1984, in this case, Mr. Glenn Jennings, Executive Vice President, during cross examination by Mr. James T. Gilbert, counsel for the City of Berea, stated:

> Secondly, Delta has acquired five operations since I've been involved with it, and we've never paid a cent over net book value of the assets. We've negotiated on that basis with people. We've sat down at the table with them and said, "That's all we've going to pay because that's historically what the Commission allows," and its either - that's the starting point and the finishing point for us on the purchase price".

This statement is troublesome to me - from two standpoints. Mr. Jennings indicates that "net book value of the assets" is the starting point. There are instances where this may very well not be the starting point.

Mr. Jennings further states: "That's all we're going to pay because that's historically what the Commission allows". Commission practice over the years, as far as I can determine, has been to approve acquisitions which are consummated at net original cost (where no acquisition adjustment is involved) without exploring whether the utility acquiring the property should have bargained for something better because of the particular situation - condition of the facilities, etc. The Commission is now moving in a different direction.

The fact still remains that the acquisition adjustment was on the books of Gas Service. It was recognized by the Commission in authorizing the financing for Delta to acquire the property. In a later case it was ratified and included for ratemaking purposes with a specific reference to Delta's commitment to improve service.

In summary, it is my opinion that the policy set forth in the Commission's Orders in Case No. 8256 and Case No. 8528 and quoted above should be changed. Further, considering the equities as reflected in the evidence of record and the prior cases discussed above, I believe the acquisition adjustment should be allowed.

Richard D. Heman, Jr.

Richard D. Heman, Jr.
Chairman

Delta Natural Gas Company

Case No. 9059

Concurring Opinion

While I cannot totally disagree with the substance of Chairman Heman's dissent, I do disagree with its appropriateness in this case. The intervenors in this case were not put on notice that a change was being considered. Furthermore, such a change, if it is to be made, should be made in a case where the issue is substantial enough to lead to the development of a complete record. Otherwise, it will stand as an indication of a "policy" change that could be persuasive in other cases where the amounts involved and the impact on consumers are much greater. It is my opinion that there are several similar "policies" that need to be reevaluated in the proper case after notice that the issue is being considered and after a full record is developed. It has been a long-standing hope of mine that it will be possible to examine some of these issues in generic proceedings, but that has not been possible during the last two years because of the overwhelming work load of telephone-divestiture related proceedings and other major rate cases.

This situation points out a much broader problem. The routine and unthinking application of "policies" can result in grave injustice--to the regulated utilities in some instances, to consumers in other instances. The Commission is supposed to be an expert agency with the knowledge and expertise to evaluate the entirety of the situation facing a utility and its consumers and to fashion an appropriate remedy. Recent court decisions relying on rules developed in civil cases decided by lay juries seriously interfere with this process.

If regulation is to be effective, this discretion must be returned. Otherwise, discretion becomes a one-way street. If discretion is exercised in a way that is perceived as favorable to the regulated entity, then it stands, and becomes "policy," absent an appeal by the overworked, understaffed and underfunded Attorney General's office. If discretion is invoked in a way that is perceived as unfavorable by a utility, there is an immediate appeal based on the judicial jury model with reference to cases that were perceived as favorable to regulated utilities.

Laura L. Murrell
Commissioner
December 20, 1984

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9059 DATED December 21, 1984.

The following rates and charges are prescribed for the customers served by Delta Natural Gas Company, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

The following rates and charges have incorporated all changes through PGA Case No. 8528-L.

RATES SCHEDULES

AVAILABILITY

Available for general use by residential, commercial, and industrial customers who purchase their entire natural gas requirements from Delta.

RATES

	Base Rate		Gas Cost Recovery Rate		Total Rate
		plus		equals	
General Service					
Monthly Customer Charge					$3.90
1 - 1,000 Mcf	$1.9658		$4.2948		$6.2606 per Mcf
1,001 - 5,000 Mcf	1.8311		4.2948		6.1259 per Mcf
5,001 - 10,000 Mcf	1.5311		4.2948		5.8259 per Mcf
Over 10,000 Mcf	1.2311		4.2948		5.5259 per Mcf
Interruptible (2)					
1 - 1,000 Mcf	$1.7158		$4.2948		$6.0106 per Mcf
1,001 - 5,000 Mcf	1.5811		4.2948		5.8759 per Mcf
5,001 - 10,000 Mcf	1.2811		4.2948		5.5759 per Mcf
Over 10,000 Mcf	0.9811		4.2948		5.2759 per Mcf

TRANSPORTATION OF GAS FOR OTHERS
ON SYSTEM UTILIZATION

APPLICABILITY

Applicable within all areas served by Delta.

AVAILABILITY

Available to commercial and industrial customers who have purchased natural gas elsewhere, obtained all requisite authority to transport such gas to Delta's facilities and request Delta to utilize its facilities to transport such customer-owned gas to place of utilization. Any such transportation service shall be subject to the terms and conditions set forth herein and to the reserved right of Delta to decline to initiate such service whenever, in Delta's sole judgment, the performance of the service would be contrary to good operating practice or would have a detrimental impact on other customers of Delta.

RATE

A transportation charge comprised of the following components will be applied to each Mcf, or, in the case of measurement based on heating value, each dekatherm (Dth) of gas transported hereunder:

(1) Delta's Base Rate for gas sold as set forth in Delta's General Service and Interruptible Rate Schedules; plus

(2) Where the pipeline suppliers' transportation, compression or other similar charges are billed to Delta, the cost per Mcf or Dth, as applicable, of such charges.

GAS SOLD TO CUSTOMERS

Monthly gas deliveries to customer in excess of scheduled transportation volumes will be billed by Delta and paid by customer in accordance with Delta's Standby Service Rate Schedule.

TERMS AND CONDITIONS

(1) Service hereunder shall be performed under a written contract between customer and Delta setting forth specific arrangements as to volumes to be transported, points of delivery, methods of metering, timing of receipts and deliveries of gas by Delta, the availability of discounts in special situations and any other matters relating to individual customer circumstances.

(2) At least ten (10) days prior to the beginning of each month, customer shall provide Delta with a schedule setting forth daily volumes of gas to be delivered into Delta's facilities for customer's account. Customer shall give Delta at least twenty-four (24) hours prior notice of any subsequent changes to scheduled deliveries. Delivery of gas transported hereunder will be effected as nearly as practicable on the same day as the receipt thereof. Delta will not be obligated to utilize underground storage capacity in performance of the service provided herein.

(3) All gas volumes delivered hereunder shall shrink by 2% to cover line loss and measurement differences when no compression is being used in the transportation. When compression is required in the transportation, all gas volumes delivered hereunder shall shrink an additional 3% to cover compressor fuel.

(4) It shall be the customer's responsibility to make all necessary arrangements, including regulatory approvals, required to deliver gas transported under this tariff.

(5) Delta reserves the right to refuse to accept gas that does not meet Delta's quality specifications.

(6) Volumes of gas transported hereunder will be determined in accordance with Delta's measurement base.

(7) Customer owned gas transported hereunder for an interruptible customer will be subject to interruption in accordance with normal interruption procedures applicable to such rate schedule. Such customers must agree in writing to cause deliveries of customer-owned gas into Delta's facilities to cease upon notification by Delta of the necessity to interrupt or curtail the use of gas.

(8) Delta shall have the right at any time to curtail or interrupt the transportation or delivery of gas hereunder when, in Delta's sole judgment, such curtailment or interruption is necessary to enable Delta to maintain deliveries to retail customers of higher priority or to respond to any emergency.

(9) Delta may execute special transportation contracts with anyone subject to approval of said contract by the Public Service Commission.

TRANSPORTATION OF GAS FOR OTHERS
OFF SYSTEM UTILIZATION

AVAILABILITY

Available to any person whose failities connect or can be made to connect with Delta's facilities or who can cause their natural gas to be delivered to Delta's facilities and who desires gas to be transported by Delta to a place of utilization not connected to Delta's facilities. Further, the person or persons desiring such transportation shall have executed a contract with Delta as set forth under the terms and conditions of this tariff.

TERMS AND CONDITIONS

(2) Delta shall reserve the right to purchase all or part of the gas to be transported at the same price the transporter would have received at the delivery point.

(3) Delivery of gas transported hereunder will be effected as nearly as practicable on the same day as the receipt thereof. Delta will not be obligated to utilize underground storage capacity in performance of the service provided herein.

(6) Delta reserves the right to refuse to accept gas that does not meet Delta's quality specifications.

(7) Volumes of gas transported hereunder will be determined in accordance with Delta's measurement base.

(8) Delta shall have the right at any time to curtail or interrupt the transportation or delivery of gas hereunder when, in Delta's sole judgment, such curtailment or interruption is necessary to enable Delta to maintain deliveries to retail customers of higher priority or to respond to any emergency.

(9) Delta may execute special transportation contracts with anyone after approval of said contract has been granted by the Public Service Commission.

STANDBY SERVICE RATE SCHEDULE

APPLICABILITY

Applicable within all areas served by Delta.

AVAILABILITY

Available for use by commercial and industrial customers who:

(1) purchase all or part of their natural gas requirements from sources other than Delta and who request Delta to be available to supply natural gas at their place of utilization; or

(2) request Delta to provide a standby energy source at their place of utilization.

CHARACTER OF SERVICE

Firm - within the reasonable limits of Delta's capability to provide such service unless otherwise specified in a contract between Delta and the customer.

RATES

Customer shall pay Delta a standby charge to be set forth in a contract between Delta and the customer that has been approved by the Public Service Commission. In addition, monthly natural gas usage will be billed by Delta and paid by the customer in accordance with the charges set forth in Delta's General Service or Interruptible Rate Schedule under which it sells gas to the customer.

SPECIAL TERMS AND CONDITIONS

Service under this rate schedule shall be performed under a written contract between Delta and the customer setting forth specific arrangements as to standby charge, maximum daily volumes of natural gas required by customer from Delta, points of delivery, methods of metering, and other matters relating to individual customer circumstances.